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Noah Smith doesn't even try to argue otherwise

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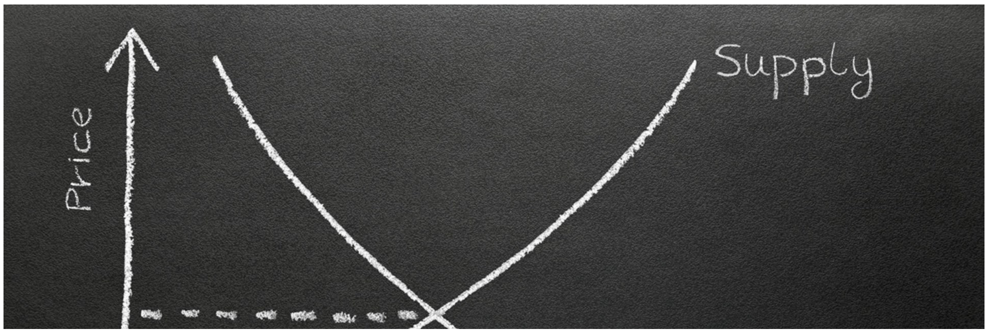


David R. Henderson

Economics Basic Welfare Minimum Wage Employment

Economist Noah Smith has a recent article titled "Most of What You Learned in Econ 101 Is Wrong." He doesn't actually make the case that would support that title. But he also probably didn't choose the title. However, he did choose this statement:

> But [N. Gregory] Mankiw's book, like every introductory econ textbook I know of, has a big problem. Most of what's in it is probably wrong.

Here's what's striking: In an article that purports to show that Mankiw is wrong on many issues, he doesn't point out how he's wrong on *any* issues.

Moreover, he doesn't even try. At no point in his piece, does Smith ever relate anything he says to specific things that Mankiw claimed.

Of course, it's possible that Smith doesn't think he needs to do so because he takes as given that his audience knows what's in Mankiw's text.

So let's look at that. On the minimum wage, Smith writes:

> For example, Econ 101 theory tells us that minimum wage policies should have a harmful impact on employment. Basic supply and demand analysis says that in a free market, wages adjust so that everyone who wants a job has a job — supply matches demand. Less productive workers earn less, but they are still employed.
>
> If you set a price floor — a lower limit on what employers are allowed to pay — then it will suddenly become un-economical for companies to retain all the workers whose productivity is lower than that price floor. In other words, minimum wage hikes should quickly put a bunch of low-wage workers out of a job.

And Smith gives his criticism in the next paragraph:

> That's theory. Reality, it turns out, is very different. In the last two decades, empirical economists have looked at a large number of minimum wage hikes, and concluded that in most cases, the immediate effect on employment is very small. It's only in the long run that minimum wages might start to make a big difference.

In other words, in most cases there is a small, presumably negative, effect on employment. And presumably in the other cases there is a large effect. How, exactly, does this contradict the claims that Mankiw makes and that many of us teach in our equivalents of Econ 101? It doesn't.

Now it is true that in the 5th edition (2009) of his text, Mankiw writes:

> Although there is some debate about how much the minimum wage affects unemployment, the typical study finds that a 10 percent increase in the minimum wage depresses teenage employment [by] between 1 and 3 percent.

In light of the more recent studies that Smith is referring to, Mankiw might need to soften that statement. But he need not change his conclusion that the minimum wage puts some teenagers out of work. So Smith, in an article purporting to disagree with Mankiw on this, finds himself agreeing.

The other issue on which Smith takes issue with how Econ 101 is taught — or is it Mankiw's text? — is on welfare. Smith writes:

> Another example is welfare. Econ 101 theory tells us that welfare gives people an incentive not to work. If you subsidize leisure, simple theory says you will get more of it.

What's Smith's objection? He writes:

> But recent empirical studies have shown that such effects are usually very small. Occasionally, welfare programs even make people work more. For example, a study in Uganda found that grants for poor people looking to improve their skills resulted in people working much more than before.

But here he's attacking a straw man. Economists who have claimed that welfare discourages work have generally had in mind welfare programs that impose a very high implicit marginal tax rate because the people on welfare lose a lot of their welfare payments when they work more.

Go to the link he cites and you find that he's talking about the kind of welfare is typically in the form of unrestricted cash grants that, presumably, they don't lose if they work more. That means that such welfare programs do not — repeat *do not* — subsidize leisure.

That certainly doesn't contradict the standard exposition in Econ 101 or the exposition in Mankiw's text. Mankiw discusses a hypothetical welfare program in which the government guarantees an annual income of $15,000 and then takes away one dollar of welfare for every dollar earned. He writes:

> The incentive effects of this policy are obvious: Any person who would make under $15,000 by working has little incentive to find and keep a job.

Why? Mankiw explains:

> In effect the government taxes 100 percent of additional earnings.

Do the studies the linked article that Smith cites contradict this? No. In fact, here's what the linked article states:

> There's no doubt that poorly designed social programs can deter work. Aid to Families With Dependent Children, the pre-welfare reform welfare program, was found to decrease hours worked by 10 to 50 percent among recipients; that likely has something to

> do with the fact that AFDC benefits were taken away at a rate of 100 percent, so every dollar earned on the job was a dollar not received from AFDC. Who would work under that condition?

Exactly.

H/T to Don Boudreaux.

Cross-posted from Econlog.

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